

The Community Reinvestment Act

Extraordinary Leverage for Disenfranchised Communities

Debbie Warren

In America, access to credit is one of the few routes to economic progress for those not born into wealth. For *communities* in our country, access to credit is critical if homes will be built and maintained; businesses will emerge, survive and grow; family farms will continue; and children will be educated. The existence of the Community Reinvestment Act (CRA) reflects the recognition that access to credit in the United States is an uneven playing field, with minorities, in particular, handicapped by inadequate net worth, little collateral, bumpy credit histories, high debt burdens and minimal relationships with key decision-makers. Furthermore, recent studies and news stories have documented the evidence of racial bias in lending.¹ The CRA has proved to be a potent tool to help level out this uneven playing field, leading to new flows of credit in inner-city, rural and minority communities.

The intent of this article is to: 1) provide background information on the CRA; 2) discuss its use in North Carolina, home of two of the nation's largest banks; 3) foreshadow what the future holds for CRA users; and 4) highlight how planning skills are critical to the advocacy process and how planners in the public and non-profit sectors can use this critical development tool.

Background on The Community Reinvestment Act

The CRA was enacted by Congress in 1977 in response to the perceived "redlining" by banks and savings

& loans. "Redlining" is the practice of excluding minority, inner-city and low-income communities from access to credit. The CRA's companion pieces, the Fair Housing Act of 1968, the Equal Credit Opportunity Act of 1976, and the Home Mortgage Disclosure Act of 1975 and 1980, were all seen as tools to insure that financial institutions would use lending criteria that were both race and gender neutral.

This law says that financial institutions, banks and savings and loans associations, have a "continuing and affirmative" obligation to help meet the credit needs of their communities, including low- and moderate-income areas, consistent with safe and sound lending practices. The CRA reaffirms the financial institutions obligation to meet the "convenience and needs" of the communities from which they take deposits in order to receive a charter from the federal government. CRA, consequently, expanded and defined the federal concept of "convenience and needs" to include not only depositary needs, but credit needs as well.

The CRA provides a legal framework which the community, made up of residents, businesses, and organizations, can use to encourage their lenders to respond to community credit needs such as loans for home purchase and improvement, small business startup and growth, and real estate development. CRA does not require specific loan commitments; it does encourage bank initiatives to increase dialogue, knowledge and responses to community credit needs.

CRA performance enters at two points of the federal regulatory process: 1) when a financial institution applies for a change in its status such as an acquisition, merger or branch opening/closing; and 2) during the regulators' periodic examination processes for both "safety and soundness" and "convenience and needs." The 1989 Joint Statement by the four regulatory agencies involved in the process, Federal Reserve Board, Office of Thrift

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Supervision, Comptroller of the Currency and the Federal Deposit Insurance Commission, standardized the regulators' approach to the CRA application and examination process.

Performance Evaluation

The regulatory agencies look at five broad performance categories when evaluating a bank's CRA performance:

- 1) Ascertaining community credit needs;
- 2) Marketing and types of credit extended including residential mortgages, home repair and rehabilitation, small business and small farm loans; and the institution's participation in public sector loan programs;
- 3) Geographic distribution of loans and the record of opening and closing branches;
- 4) Discrimination and other illegal credit practices; and
- 5) Participation in local community development projects and/or programs.

After a CRA evaluation, the bank or S&L is given a rating of outstanding, satisfactory, needs to improve, or substantial noncompliance, and the evaluation is made available to the public. In assigning the rating, the examiners are required to take into account variables such as a bank's size, expertise, financial strength, type of market it serves, local economic conditions, and the nature of the institution's competition and business strategy.

As part of their compliance, financial institutions covered by the CRA must publish a CRA Statement describing their lending community and the types of credit offered. The CRA Statement must be posted in the office of each institution. Furthermore, the banks and S&Ls must maintain a public comment file which is scrutinized by the regulators.

The regulators are a key part of the CRA process as they set the parameters for measuring CRA compliance. Most of the banks take their cues from the regulators. Unfortunately, most of the regulators are unfamiliar with the complexities of

community development finance and have no contact with community representatives or public officials. The vast majority of institutions get a satisfactory or outstanding rating in these annual or bi-annual reviews. In North Carolina, for example, four of the largest banks have received outstanding ratings in the past two years. Rather than regarding CRA examination as the most challenging piece of the process, requiring the most sophisticated skills of all of the regulatory areas, the regulators are generally unschooled and focus on "safety and soundness". The appointment of a new Comptroller of the Currency by President Clinton signals upcoming reforms of the CRA examination process.

The Home Mortgage Disclosure Act

The passage of the Home Mortgage Disclosure Act (HMDA) by Congress in 1975 provided advocates with the only public source of data about bank lending in low-income and minority communities. Expanded in 1989, HMDA requires all banks, savings and loan associations and credit unions with more than \$10 million in assets to report the number and dollar amounts of their housing applications and approvals by census tract, income, gender and race. Only Metropolitan Statistical Areas (MSAs) are covered by HMDA.²

Since the 1989 requirement that loan denials as well as approvals must be submitted to the regulators, several national and local studies have publicized patterns of major disparities in denial rates for minorities, as compared to whites of similar incomes. (See Peter Skillern's article on page 35 of this issue for a more detailed discussion on HMDA.)



Avonlea, a North Raleigh community, is an example of affordable housing developed with CRA financing.

Interstate Banking: Critical Window of Opportunity

CRA only became an effective tool for community advocates with the passage, in many states, of interstate banking laws in the early to mid 1980's. Crossing state lines to acquire banks in profitable markets became a critical piece of the growth strategy of large financial institutions, who had swallowed up most of the profitable community banks in the prior two decades. These acquiring institutions did not want to see their deals delayed through a federal approval process extended by the filing of the CRA comment. Prior to interstate banking, bank applications focused on less critical changes in status such as opening or closing a branch office. With interstate acquisitions at stake, it was common, consequently, to see top bank officials at the negotiating table with community advocates hours after the group announced its intention to protest the merger or acquisition. Such leverage, on the part of disenfranchised minorities and the poor, was previously unheard of.

Stakeholders in the Community Reinvestment Process

In sum, the Community Reinvestment Process is a four-pronged effort involving financial institutions, community representatives, regulators and the public sector. The bankers' response to the CRA has ranged from hostility, and allegations of "blackmail" and "credit allocation," to a full recognition of the role of CRA lending in the institution's primary ways of doing business. A good CRA lender has staff with sound knowledge and growing experience in community development finance. These institutions have solid relationships with a range of community leaders, businesses and service providers, conduct aggressive marketing and outreach, and build partnerships with government programs. For them, community development lending is profitable and good business. In between these two extremes lie the banks who simply meet minimal requirements or who effectively promote their programs, often short on substance and commitment, through the media.

The public sector has a broad array of tools to encourage bank participation in targeted communities to both reduce risk and minimize transaction costs. Such tools include linked-deposit ordinances under which the governmental entity only does business with institutions with an acceptable CRA record, public funds to leverage



Patricia and James Ramsey live in Avonlea, apartments built with loans from area banks.

private sector investment, technical assistance for lenders and community organizations, and political goodwill for lenders with strong CRA records.

Traditionally there have been two primary objections among lenders to community development lending--cost and risk. Cost can be reduced by specializing in a particular type of lending, or shifting transaction costs to a third party. The public sector also can help reduce the high transactions cost of community development lending by supporting counselling and technical assistance activities and thus shifting transaction costs to a third party. Risks can be reduced through the use of public guarantees and subordinated loans, secondary markets, and borrower technical assistance.

The "community" is a diverse set of voices united by a common vision: to see their community's pattern of disinvestment and decline reversed. The community can be a small town, a rural county or a low-income or

minority neighborhood inside a city. CRA has been unique in the history of federal legislation in giving the "community" standing to intervene in the bank application process.

CRA Experience in North Carolina

CRA began in North Carolina in the fall of 1986, with the challenge of First Union National Bank's application to acquire a small bank near Atlanta. The comment and negotiation process was entirely carried out by legal services advocates. Subsequent challenges involved a broader spectrum of local and state advocates including representatives of small and minority businesses and farms, community-based development organizations, churches and community action agencies. Since that first challenge, the negotiating process has been carried out with all of the state's largest financial institutions and several S&Ls and community banks. Three banks have now been through this process twice.

General statements about marketing and outreach, types of lending programs, technical assistance and board diversity were common to the early statewide agreements reached between the community representatives and the bank. The second stage of CRA negotiations included specific agreements for the bank's headquarters city, in the form of administrative and program-

matic grants for community development corporations. The third stage, beginning in 1991, encompassed dollar-specific statewide agreements. The program reached with First Citizens Bank, for example, involved \$25 million worth of lending and grant commitments in housing purchase and development, small and minority businesses, small farms engaged in sustainable agricultural practices and capacity building of Community Development Corporations.

Much of the success of CRA advocacy in North Carolina is due to consistent staffing at the statewide level. The statewide legal services program has supported CRA advocacy for the past seven years, with additional financial resources provided by the Mary Reynolds Babcock Foundation. Statewide support is critical because all of the state's major banks operate on a statewide scale. Though each community has to develop its own relationships with local lenders and prioritize its own credit needs, the necessary top level support can only be achieved at the statewide level. Furthermore, statewide staffing is necessary to ensure that local groups coordinate.

The lack of consistent staffing at the statewide level is characteristic of many states, and certainly true of those in the South. As a result, successful advocacy efforts are more likely to be found in major urban centers, with the smaller cities and rural areas left behind.

Benefits of CRA Advocacy

The most important benefit has been the development of relationships between community developers, activists and leaders and the local power structure. Bankers, who are primarily white, make their business contacts through their social, civic and religious organizations. These organizations are traditionally segregated in America and consequently, key business relationships are rarely developed by the minority community. CRA brings these players to the same table, talking about credit and economic development. At some point, both parties realize that the successful development of the entire community must include the successful development of the minority and low-income communities.

Non-traditional developers have also benefitted from CRA. Cooperatives, non-profit housing developers, land trusts and Community Development Corporations typically found it impossible to secure financing from banks. Bankers did not understand their organizations or the structure of their deals and had no incentives to take the extra steps and absorb the additional transaction costs. With CRA, bankers are doing deals with these new actors in the development community.

Mortgage lending has been the most successful arena for CRA product development. Every major bank in North Carolina has an "affordable housing product", complete with reduced fees, relaxed underwriting, deeper



Park Worth is another CRA affordable housing community.

looks at credit blemishes, fixed 30 year rates, and counselling workshops. I estimate that approximately \$500 million in housing loans for lower-income families has been extended in the past three years in North Carolina under these programs.

The reasons for this success in the mortgage arena are three. First, mortgage lending is relatively simple--standardized guidelines can be developed for these real estate deals. Second, HMDA provides the public with data about the mortgage lending performance of financial institutions. Banks don't like unfavorable publicity: they feel pressured to improve their performance. And third, the regulators do not understand small business lending and emphasize mortgage related initiatives.

CRA has also meant a greater sensitivity on the part of financial institutions to discriminatory underwriting or treatment of minority customers. Most large banks have "second review" policies where denials of minority applicants result in scrutiny by a senior lending officer. A growing number of banks provide training to bank employees on potentially discriminatory behaviors; some are engaged in testing their own staff.

Finally, CRA has enabled the public sector to more effectively administer their lending programs as well as leverage housing and commercial development dollars. Because of CRA, more banks are interested in originating and servicing city loan programs and in reducing the cost and paperwork associated with these activities. In addition, banks are now sitting down with community development staff, figuring out how private and public programs can operate in tandem. Critical public dollars are being stretched.

The primary area where CRA has not produced significant results is in small and minority business lending. Though commercial lenders now regularly call on minority businesses across the state, no bank has developed an effective program for meeting the diverse needs of these markets. Attitudes towards risk in the commercial sector remain much the same.

The converse of the explanations for the success of mortgage-related initiatives serves to explain the lack of success in the business arena. Business and commercial lending is much less adaptable to standard underwriting; lack of a commercial version of HMDA means the banks are less publicly accountable in this sphere of lending.

Future Developments in CRA

New CRA regulations are expected to be issued in January 1994. At President Clinton's urging, the regulators are looking to emphasize performance rather than paperwork processes, and to minimize the "paperwork burden" of the regulated financial institutions. It is likely that performance will be judged in the context of a local plan rather than by performance indicators.

CRA advocates continue to press for commercial loan disclosure so that rates of lending to small minority-owned businesses can be examined. Training of regulators in community development lending also remains a concern. Equally significant, Congress is likely to approve nationwide banking within the next several years. Nationwide markets will mean the further centralization of decision-making, away from the community with standardized products and underwriting, and may result in increased reluctance to lend in rural areas.

Planners and CRA

I see two major roles for planners in the CRA process, in the research phase and in the development phase. First, planners, unlike lawyers, organizers and many community developers, are comfortable with data and number crunching. These skills are necessary for the critical HMDA analyses, for helping community groups assess local credit needs, and for developing programs to meet these needs. Planners can form productive relationships with community-based developers and activists in these local CRA processes.

Second, many planners work in local and state government, developing housing and commercial lending programs with public resources. Planners can use the CRA to effectively leverage bank participation in these programs, both as lenders and as processors. In addition, planners are increasingly finding jobs with community-based development organizations. Responsible for packaging real estate deals, these planners must know how to attract bank participation and develop strategic partnerships.

Summary

The Community Reinvestment Act has been a critical tool in opening up the banking community to the needs of, and opportunities in, minority and low-income communities. Bankers now routinely meet with community leaders and developers, develop products and services to meet these needs, provide incentives for lending officers to make CRA loans, give grants to community-based development organizations, include a handful of minorities on their boards and problem-solve together. Planners must be a part of this relationship building. CP

Notes

¹A study of mortgage lending in the Boston area by the Federal Reserve Bank (October 1992) found that African American and Latino mortgage applicants were approximately sixty percent more likely to be denied a mortgage loan than whites with similar income, credit history, debt burdens and loan-to-value ratios.

²Metropolitan Statistical Area (MSA) is the definition used by the Bureau of the Census to define an urban area comprising one or more counties which have a population of more than 50,000.